No. 10,078

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

HELEN M. SUTHERLAND, CHARLES W. SUTHERLAND, M. I. HIGGENS, MAYBELLE HIGGENS and HELEN MAUDE LORENZ,

Appellants,

vs.

FRANK A. GARBUTT, CHANDIS SECURITIES COMPANY, a corporation, ALICE CLARK RYAN, LOG CABIN MINES COMPANY, a corporation, and MUTUAL GOLD CORPORATION, a corporation,

Appellees.

APPELLANTS' OPENING BRIEF.

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APPELLANTS' OPENING BRIEF.

Jurisdiction.

This is an appeal from a decision of the United States District Court, Southern District of California, Central Division, rendered October 30, 1941, wherein the District Court rendered judgment for the defendants below, who are appellees in this Court.

Diversity of citizenship exists as between the plaintiffs and the defendants [Complant, par. I, II, Tr. 2, 3;

Emphasis throughout the brief is supplied.

Answer Mutual Gold, par. I, Tr. 133; Answer Chandis Securities Company, par. I, Tr. 145; Answer Frank A. Garbutt *et al.,* par. I, Tr. 122; Findings I, II and III, Tr. 180, 181]. The matter in controversy, exclusive of interest and costs, exceeds the sum of $3,000.00 [Complaint, par. III, Tr. 3; Finding VII, Tr. 182]. Jurisdiction of the District Court therefore lies under Sec. 41 (1), Title 28, U. S. C. A. (Judicial Code, section 24, amended).

Appellant has appealed to this Court from paragraph I of the final judgment [Tr. 207]. Notice of appeal was given within three months from October 30, 1941, to wit, January 26, 1942 [Tr. 208]. Jurisdiction of this Court therefore lies under section 225(a) First, and (d), Title 28, U. S. C. A. (Judicial Code, section 128, amended).

Introductory Statement.

This is a derivative action brought by plaintiff stockholders of appellee Mutual Gold Corporation, a corporation organized under the laws of the State of Washington [Finding III, Tr. 181]. The plaintiffs have not waived or consented to the acts complained of [Tr. 699, 700, 719-723, 725, 738].

The facts of the case are complicated but by way of introduction may be summarized in a single paragraph as follows:

Appellee Mutual Gold Corporation, a Washington mining corporation, hereinafter referred to as "Mutual Gold", needing funds to pay its debts and more fully develop its

gold mine, had two offers of financial assistance. It accepted the one made personally by appellee Frank A. Garbutt, hereinafter referred to as "Garbutt", the agent of the owners of the mining claims being purchased by it. Garbutt obtained majority ownership and control of the mine. This was accomplished by making and pressing on behalf of the owners a forfeiture of the contract through which the mine was being purchased by Mutual Gold. Through this means Garbutt induced Mutual Gold to enter a series of contracts, which can be considered as one transaction, pursuant to which Mutual Gold conveyed substantially all of its assets to Log Cabin Mines Company, hereinafter referred to as "Log Cabin", a California corporation formed for the purpose of accepting said assets and carrying out Garbutt's offer. Said corporation had no other assets except $10,000.00 subscribed for its stock. A minority of the stock of Log Cabin was issued to Mutual Gold and a majority went to said Garbutt who promoted and controlled Log Cabin as his creature corporation. The only consideration given for this transaction by Garbutt was the agreement upon Garbutt's part to advance $10,000.00 about to become due on the purchase price of the mining claims, he having the right to retire at any time from other optional commitments of the contracts. No provision was made to take care of the outstanding creditors of Mutual Gold. These contracts were authorized either by the directors alone or by additional vote of less than all the stockholders of Mutual Gold.

Questions Involved in This Appeal.

1. Where a mining corporation was organized in the State of Washington under laws which did not provide for the transfer of all the assets of the corporation, may substantially all such assets be sold or exchanged without unanimous consent of the stockholders if the corporation is a solvent, going concern, or for anything other than cash if the corporation is insolvent or in a failing condition?

2. Does the power reserved in the constitution of the State of Washington to amend the corporate laws permit the Legislature to adopt an amendatory corporation law governing the transfer of all the assets of such corporation or are the rights of the stockholders of said Washington corporation with respect to the sale or exchange of assets, vested rights and therefore entitled to protection under federal and state constitutional provisions relating to impairment of the obligation of contracts and due process of law?

3. Does said 50% of the stock issue of said mining corporation, less one share, together with the obligation of said promoter and manager to advance $10,000.00 to pay installment on purchase of company's assets consisting of mining claims, plus only his optional right to advance certain monies toward the development of said mining property, constitute an adequate consideration for the transfer of substantially all the assets of said mining corporation?

4. Can a corporation sell or exchange substantially all of its assets without notice to the stockholders that such action will be taken?

5. Does a notice of a stockholders' meeting stating that such meeting shall act upon a proposed specific transaction with a named party and a sale of the assets as the stockholders may determine, and shall make such other or different agreement as they in their absolute discretion deem advisable, constitute a notice sufficient to authorize a contract with another unnamed party for sale or exchange of substantially all the assets for one-half of the capital stock less one share of the stock of a new corporation plus certain optional rights not requiring said unnamed party (who became the manager and majority stockholder of said new corporation) to advance certain monies toward the development of the corporation's properties?

6. Was said transfer authorized by the articles of incorporation providing that said Washington corporation might sell, exchange, lease, or in any other manner dispose of the whole or any part of its property?

7. Did the right of said manager to advance money for the development of said property with optional right to withdraw at any time pursuant to a contract between said Washington corporation, said manager and said new corporation, providing that the net proceeds accruing to the Washington corporation should first be paid to discharge its indebtedness to its creditors, amount to an

adequate provision for the taking care of said creditors without which the transfer would be illegal and void?

8. Was said transfer of assets illegal and void for the reason that it made no provision for the creditors of the Washington corporation and thereby violated certain federal and state constitutional provisions relating to the impairment of the obligation of contracts and due process of law?

9. Where the agent of the owners of certain mining claims, under process of sale by installment contract to a corporation, declared and pressed a forfeiture of said sale contract, and at the same time negotiated and consummated an agreement between said purchasing corporation and said agent personally, providing for the sale or exchange of substantially all the assets of said corporation to a new corporation of which said agent was promoter, manager and majority stockholder, do said acts bring this transaction within the doctrine of business compulsion, rendering said sale or exchange illegal and void or voidable?

10. Is a contract and sale or transfer of assets of a mining corporation to a new corporation organized for the sole purpose of acquiring said assets, illegal and void where the promoter, manager and majority stockholder of said new corporation negotiated said contract as trustee for said mining corporation and as a representative of the new corporation, and also derived certain personal benefits thereunder?

11. Was said contract illegal and void because of the existence of certain common directors on the boards of the transferor and transferee corporations?

Statement of the Case.

The facts will now be stated more fully, but as briefly as their complicated character will permit.

Mutual Gold was a mining corporation organized May 11, 1932, under the laws of the State of Washington [Finding III, Tr. 181]. Its principal asset was the purchase contract of its mining claims known as the Log Cabin Mine, situate in Mono County, California [Tr. 23, *et seq.*; Finding VIII, Tr. 182, 183]. This contract, as amended, provided for payment of annual installments of $10,000.00 during the period involved in this action. Mutual Gold as assignee of the original purchasers entered into possession, paid a total of $20,000.00 on said purchase price and expended in excess of $150,000.00 [Finding IX, Tr. 183] constructed a pilot mill [Finding X, Tr. 184], and in 1936 made a contract whereby J. A. Vance, director, vice president, a large stockholder and the largest creditor of the company, was appointed general manager in charge of operations until outstanding production notes should be paid [Finding X, Tr. 185; Tr. 42]. Later, under the transactions complained of Garbutt took possession and control.

In July, 1938, Mutual Gold was in need of funds to build a larger mill and Lloyd J. Vance, son of said J. A. Vance, for himself and J. A. Vance, submitted a plan in substance that Mutual Gold assign a half interest in its assets to a corporation to be organized which was to have the operation of the mine, opportunity being given to the stockholders of Mutual Gold to subscribe for stock in this corporation [Finding X, Tr. 184; Tr. 232, 255, 257]. The Vance plan made provision to take care of outstanding obligations owed to Mutual Gold's creditors

[Tr. 234-236, 261, 266]. The directors of Mutual Gold, at the meeting of July 18, 1938, authorized this plan to be submitted to a stockholders' meeting to be held August 6, 1938 [Tr. 236]. Neither the president's letter [Finding XII, Tr. 187; Tr. 241], the call for the meeting [Finding XI, Tr. 186; Tr. 239], nor the form of proxy solicited [Finding XIII, Tr. 188], made mention of Garbutt or of a new corporation to be organized to take over the assets of Mutual Gold or of the transactions ultimately arrived at. The stockholders' meeting of August 6th, by a vote of somewhat in excess of two-thirds of the outstanding stock, gave discretion to the board of directors to sell or otherwise dispose of the assets as they might determine [Findings XIII, XIV, Tr. 187-190]. At the directors' meeting held the same day the cleavage caused by the attempts of both Vance and Garbutt to obtain a contract continued [Tr. 246, 241, 252, 272-277]. The majority declined to go through with the Vance deal and continued negotiations that had begun with Garbutt [Tr. 277]. While these negotiations were in progress, on August 25, 1938, Garbutt, as representative of the owners of the mining claims, mailed a notice of forfeiture of the purchase contract to Mutual Gold and to Vance, its manager [Tr. 278]. This was read at the directors' meeting of August 27, 1938 in Spokane, and a resolution passed that the board proceed to Los Angeles. Stiegler, the president, Grill, also the attorney for the company, and other directors went to Los Angeles, and under date of September 2, 1938 Mutual Gold and Gar-

butt entered into the contract of that date, which was subsequently re-executed on September 22, 1938. On September 2, 1938, the very day the first contract was signed, Garbutt wrote a second letter of forfeiture, and on September 9, 1938 a third letter of like tenor [Tr. 279, 289]. Other pressure was brought to bear by Garbutt [Tr. 386, 387]. Garbutt's representation of the owners, who are appellees Alice Clark Ryan and Chandis Securities Company, continued until October 3, 1938 when notice of termination of his agency was given by the owners in a letter reiterating the forfeiture [Tr. 314]. There were confused efforts to obtain full corporate ratification by Mutual Gold, including the calling of a stockholders' meeting and its cancellation [Finding XVII, Tr. 191; Tr. 288, 295, 296, 305]. September 19, 1938 the board specifically approved the September contract, declining to reconsider its approval of September 7, 1938 [Tr. 301-303, 285, 286]. The stockholders never ratified said contract. See also Finding XVIII, Tr. 191, which quotes the resolution of ratification set out at Tr. 303, 304, but erroneously refers to the meeting as September 7, 1938 instead of September 19, 1938.

Meanwhile, and prior to September 2, 1938, Garbutt had advanced $500.00 on deposit for construction of a power line, had employed Haley and Sturgeon as superintendents at the mine. On September 21, 1938 Mutual Gold transferred its assets to Garbutt by deed, assignment of the purchase contract and bill of sale [Tr. 58, 60, 62; Finding XIX, Tr. 192]. On October 15, 1938

the owners of the mining claims reinstated the purchase contract and thereafter Garbutt continued his preparation for the development of the property. On October 19, 1938 Log Cabin was incorporated under the laws of California by Garbutt, who at all times completely controlled said corporation, acting as promoter, trustee, general manager, principal creditor and being the majority stockholder [Findings XX-XXIII, Tr. 193, 194]. On October 31, 1938 Garbutt gave notice of termination of the September contracts and attached to said notice an interim agreement of November 1, 1938 between Mutual Gold and Garbutt [Finding XXVI, Tr. 194, 195; Tr. 65]. It was ratified by the board of directors on November 7, 1938 with no attempt to obtain stockholders' approval [Tr. 322-324]. Mutual Gold subscribed to all the capital stock of Log Cabin, borrowing from Garbutt $10,000.00 for the purpose [Finding XXX, Tr. 197]. 50% less one share of Log Cabin stock was issued to Mutual Gold and 50% plus one share to Garbutt [Finding XXXII, Tr. 198]. Log Cabin was organized for the express purpose of acquiring the assets of Mutual Gold and operating the same, it never engaged in any other business and never had any assets except said $10,000.00 and all the assets of Mutual Gold which were subsequently conveyed to it. It was impossible to operate the mine on Log Cabin's capitalization, as all parties well knew [Finding XXIV, Tr. 194]. As will appear from the analysis of the contracts below no further working capital was to be supplied by Garbutt as a firm obligation except $10,000.00

for the next installment payment to the owners. There ultimately was evolved the contract of December 17, 1938 between Mutual Gold, Garbutt and Log Cabin [Finding XXVIII, Tr. 195, 196; Tr. 69.] This contract came before the stockholders on February 1, 1939 without any reference to the same being included in the notice for the meeting or by the management in soliciting proxies therefor [Finding XXIX; Tr. 606, 607]. The stockholders at said meeting directed the officers to execute the contract, this time by a vote well under two-thirds of all shares outstanding [Finding XXIX, Tr. 196; Tr. 428]. No action was taken by the stockholders with respect to the organization of Log Cabin, or the Mutual Gold subscription to the stock of that company [Finding XXI, Tr. 193; Finding XXXI, Tr. 197]. Following the December 17, 1938 contract, at various times up to August 9th of the next year, Mutual Gold and Garbutt executed deeds, assignments and bills of sale to Log Cabin, covering substantially all the assets of Mutual Gold [Finding XXX, Tr. 197; Tr. 84, 88, 92, 94, 548].

Garbutt from September 2, 1938 onward was continually in possession and control of the mine, advanced monies for its operation and took out 48,500 tons of ore for which $265,000.00 was received [Finding XXXVIII, Tr. 201].

There need be no confusion because of the successive contracts. It is true the relationship of the parties changed to some degree in their legal aspects as the situation developed. For instance, Garbutt became trustee

for and representative of Log Cabin as soon as it was formed. He was already a trustee for Mutual Gold. However, essentially there was but one transaction commencing with the contract of September 2, 1938, from which he withdrew because of a question of tax liabilitity [Tr. 533, 534], through the contract of December 17, 1938, signed by Mutual Gold about January 12, 1939. This was the most elaborate of the contracts, the one embodying the deal in a form finally satisfactory to Garbutt and the one under which most of Garbutt's activities at the mine took place. That the transaction must be considered as a whole appears by an examination of the contracts and in the substitution of one contract for the other as it suited Garbutt [Tr. 319-322, 325, 327-330].

Analysis of the contracts is of prime importance. This will demonstrate the *ultra vires* of the transaction and facilitate the examination of the remaining points of the appeal.

The September 2, 1938 contract [Tr. 51] was between Mutual Gold and Garbutt. Mutual Gold agreed to sell its said purchase agreement and substantially all its other property to Garbutt, who would organize a corporation and transfer the title thereto, the stock to be issued one-half less one share to Mutual Gold and the balance to Garbutt. He agreed expressly to make the installment purchase payment of $10,000.00 due November 1, 1938 to the owners, and to furnish an additional $90,000.00 as needed to equip the mine and make additional advances, all *at his option,* reimbursing himself out of profits or

funds available from operation. It is to be noted particularly that Garbutt is given the *express option to terminate his liability at any time after paying the first $10,000.00*. This contract was re-executed on September 22, 1938.

The contract of November 1, 1938 [Tr. 66] appended to a cancellation notice of the September contract [Tr. 65], recited that money had been advanced, including $11,000.00 for a power line. Garbutt undertook to pay the $10,000.00 falling due on November 1st, and to advance money for machinery or otherwise, *at his option.* Mutual Gold agreed to give notes and Garbutt to hold in trust titles to the property conveyed to him as security. If Mutual Gold should organize a corporation to take over the property, Garbutt agreed to transfer the property to such corporation, subject to his claim and a pledge of the stock. This agreement served merely as a stopgap and the principal contract, which is the one now purportedly in effect, is that of December 17, 1938.

This December 17, 1938 contract [Tr. 69] is between Mutual Gold, Garbutt and Log Cabin, recites that the September agreements provided for transfers in trust and to facilitate transfer to a corporation to be formed, and that the agreement of November 1, 1938 fixed the status of the parties. Mutual Gold agrees to purchase the stock of Log Cabin for cash and at the option of Log Cabin to sell to it all its assets for $10.00 and other benefits set forth, subject to Garbutt's claims. Mutual Gold acknowledges that Garbutt holds the titles to secure

the payments of monies advanced or to be advanced and to transfer the assets to Log Cabin. Mutual Gold grants Garbutt an option to purchase 5001 shares of the Log Cabin stock out of a total of 10,000. Garbutt agrees to loan to Log Cabin a minimum of $95,000.00, including present obligations of Mutual Gold to Garbutt, subject to his absolute right in paragraph 11 to terminate the contract at any time and avoid payments not yet made [Tr. 78]. If the contract should be completed and the option for 5001 shares exercised, the obligations should become the obligations of Log Cabin to be repaid out of profits from operations or a sale of the property. Garbutt agrees to proceed to equip the mine and *at his option* to take care of future payments to the owners, *at his option* to advance monies in excess of the $95,000.00. *In said paragraph 11 it is expressly stated that he may termine the contract at any time* and that liability for future advances ceases and the stock returns to Mutual Gold when his advances shall be repaid. Other provisions deal with the matter of his security and repayment and Garbutt's protection from personal liability for errors of judgment or for failure to perform.

In a word Garbutt could withdraw at will and say "Pay the bills I have run up."

None of the contracts make any provisions for taking care of Mutual Gold's creditors.

Specification of Errors.

I.

THE DISTRICT COURT ERRED IN HOLDING THAT THE SO-CALLED EXCHANGE CONTRACTS AND INSTRUMENTS ARE VALID AND LEGAL AND AUTHORIZED BY THE LAWS OF THE STATE OF WASHINGTON AS STATED IN CONCLUSION OF LAW VI [TR. 204] AND CONCLUSION OF LAW II [TR. 203].

II.

THE DISTRICT COURT ERRED IN FINDING THAT NONE OF THE ACTS COMPLAINED OF WERE PERFORMED TO EVADE OR CIRCUMVENT THE LAW OR ANY CONTRACT OR OBLIGATION OF MUTUAL GOLD CORPORATION, OR TO INJURE THE STOCKHOLDERS OR CREDITORS OF MUTUAL GOLD CORPORATION, OR JEOPARDIZE OR INTERFERE WITH THEIR RIGHTS AS STATED IN FINDING OF FACT XXXIX [TR. 201] AND CONCLUSION OF LAW III [TR. 203].

III.

THE DISTRICT COURT ERRED IN HOLDING THAT THERE WAS ADEQUATE CONSIDERATION FOR SAID SO-CALLED EXCHANGE AND THE EXECUTION OF SAID CONTRACTS AND INSTRUMENTS, AS STATED IN CONCLUSION OF LAW VI [TR. 204.]

IV.

THE DISTRICT COURT ERRED IN HOLDING THAT THE TRANSFER OF SUBSTANTIALLY ALL THE ASSETS OF MUTUAL GOLD CORPORATION, WAS AND IS AUTHORIZED BY THE ARTICLES OF INCORPORATION OF MUTUAL GOLD CORPORATION, AS STATED IN CONCLUSION OF LAW II [TR. 203].

V.

THE DISTRICT COURT ERRED IN HOLDING THAT MUTUAL GOLD CORPORATION DID NOT BY SAID TRANSACTION PUT IT OUT OF ITS POWER TO PAY ITS OBLIGATIONS OUT OF NET PRODUCTION RECEIPTS AND DID NOT JEOPARDIZE OR INTERFERE WITH THE RIGHTS OF ITS CREDITORS, AS STATED IN CONCLUSION OF LAW III [TR. 203.]

VI.

THE DISTRICT COURT ERRED IN FINDING THAT THE PURPOSE AND INTENT OF THE CONTRACT OF SEPTEMBER 2, 1938, RE-EXECUTED ON SEPTEMBER 22, 1938, AND THE CONTRACT OF DECEMBER 17, 1938, WAS THAT OUT OF THE NET PROCEEDS FROM SAID MINING PROPERTY, MUTUAL GOLD CORPORATION WOULD PAY ALL ITS OUTSTANDING INDEBTEDNESS, AND THAT THE AGREEMENT OF AUGUST 23, 1939 [EXHIBIT J] WAS EXECUTED SO THERE MIGHT BE NO QUESTION OF SAID INTENTION AS STATED IN FINDING XXXVII [TR. 200], AND IN NOT FINDING THAT NO PROVISION WAS MADE FOR THE PAYMENT OF THE CREDITORS OF MUTUAL GOLD CORPORATION.

VII.

THE DISTRICT COURT ERRED IN FAILING TO HOLD THAT SAID TRANSFER AND CONTRACTS WERE VOID AS IMPAIRING THE OBLIGATION OF THE CONTRACTS OF THE STOCKHOLDERS AND CREDITORS OF MUTUAL GOLD CORPORATION IN VIOLATION OF SEC. 10 OF ARTICLE I OF THE CONSTITUTION OF THE UNITED STATES, AND SEC. 23 OF ARTICLE I OF THE CONSTITUTION OF THE STATE OF WASHINGTON.

VIII.

THE DISTRICT COURT ERRED IN FAILING TO HOLD THAT SAID TRANSFER AND CONTRACTS WERE VOID AS DEPRIVING THE STOCKHOLDERS AND CREDITORS OF MUTUAL GOLD CORPORATION AND MUTUAL GOLD CORPORATION OF PROPERTY WITHOUT DUE PROCESS OF LAW IN VIOLATION OF THE FOURTEENTH AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES AND SEC. 3 OF ARTICLE I OF THE CONSTITUTION OF THE STATE OF WASHINGTON.

IX.

THE DISTRICT COURT ERRED IN HOLDING THAT SAID TRANSFER WAS AND IS AUTHORIZED BY THE STOCKHOLDERS OF MUTUAL GOLD CORPORATION, AS STATED IN CONCLUSION OF LAW II [TR. 203].

X.

THE DISTRICT COURT ERRED IN HOLDING THAT SAID TRANSFER WAS AND IS AUTHORIZED BY THE DIRECTORS OF MUTUAL GOLD CORPORATION AS STATED IN CONCLUSION OF LAW II [TR. 203] AND IN THE EXERCISE OF THEIR SOUND DISCRETION AS STATED IN CONCLUSION OF LAW IV [TR. 203].

XI.

THE DISTRICT COURT ERRED IN NOT FINDING THAT THE ACTS COMPLAINED OF WERE INDUCED OR INFLUENCED BY BUSINESS COMPULSION ON THE PART OF FRANK A. GARBUTT AND ARE THEREFORE VOID OR VOIDABLE AND ERRED IN FINDING ON THE CONTRARY THAT NO ACT OF MUTUAL GOLD CORPORATION, ITS OFFICERS OR DIRECTORS WAS INDUCED OR INFLUENCED BY ANY DURESS OR COERCION OF FRANK A. GARBUTT, AS STATED IN FINDING OF FACT XL [TR. 202.]

XII.

THE DISTRICT COURT ERRED IN FAILING TO HOLD SAID CONTRACT OF DECEMBER 17, 1938 AND THE TRANSFER OF ASSETS ILLEGAL AND VOID AS A RESULT OF SAID CONTRACT AND TRANSFER HAVING BEEN NEGOTIATED BY FRANK A. GARBUTT AS TRUSTEE FOR MUTUAL GOLD CORPORATION AND AS REPRESENTATIVE OF LOG CABIN MINES COMPANY AND FOR HIS OWN BENEFIT.

XIII.

THE DISTRICT COURT ERRED IN FAILING TO HOLD THAT SAID TRANSFER OF ASSETS AND CONTRACT OF DECEMBER 17, 1938, AND ALL TRANSFERS OF SAID ASSETS TO LOG CABIN MINES COMPANY WERE ILLEGAL AND VOID BECAUSE OF THE EXISTENCE OF COMMON DIRECTORS.

ARGUMENT.

Ultra Vires.

Contracts or Other Transactions Which Are Ultra Vires the Powers of a Corporation Are Void.

(a) The laws of the State of Washington govern Mutual Gold and the controversy before this Court.

The case was tried in the District Court upon the theory, which is correct, that the laws of the State of Washington control. The following authorities are cited on this point:

Commonwealth Acceptance Corporation v. Jordan (1926), 198 Cal. 618, 628-30, 246 Pac. 796;

Southern Sierras Power Co. v. R. R. Commission of Calif. (1928), 205 Cal. 479, 271 Pac. 747;

Modern Woodmen of America v. Mixer (1925), 267 U. S. 544, 69 L. Ed. 783;

Turner v. Turner Mfg. Co. (Wisc. 1924), 199 N. W. 155, 157.

(b) Under common law rules in effect in the State of Washington in 1932 Mutual Gold, a Washington corporation, cannot sell all its assets if solvent except by unanimous vote of its stockholders. If insolvent or in a failing condition such unanimous consent is not required but the sale must be for cash.

Under the laws of the State of Washington in 1932 when Mutual Gold was organized there was no provision authorizing the sale of all the assets and no machinery to govern such transfer. Common law rules therefore applied, under which a solvent, going corporation cannot

sell all or substantially all its assets without unanimous consent of its stockholders. Such consent is not required if the corporation is insolvent or in a failing condition, but in such case the sale can be only for cash.

Geddes v. Anaconda Copper Mining Co., 254 U. S. 590, 65 L. Ed. 425, is a leading authority on this point. It involved the sale of all the assets of a mining company to Anaconda Copper Mining Co. for certain shares of stock in the latter corporation, which was ratified at a special meeting of the stockholders by less than a unanimous vote. The transaction was approved because here the stock received had a wide and general market and was held to be equivalent to cash. The Court stated the rules very clearly as follows:

> "It is, of course, a general rule of law that, in the absence of special authority so to do, the owners of a majority of the stock of a corporation have not the power to authorize the directors to sell all of the property of the company, and thereby abandon the enterprise for which it was organized. But to this rule there is an exception, as well established as the rule itself; viz.: that when, from any cause, the business of a corporation, not charged with duties to the public, has proved so unprofitable that there is no reasonable prospect of conducting the business in the future without loss, or when the corporation has not, and cannot obtain, the money necessary to pay its debts and to continue the business for which it was organized, even though it may not be insolvent in the commercial sense, the owners of a majority of the capital stock, in their judgment and discretion, exercised in good faith, may authorize the sale of all of the property of the company for an *adequate consideration,* and distribute among the stockholders

what remains of the proceeds after the payment of its debts, even over the objection of the owners of the minority of such stock. Thomp. Corp., 2d ed., sections 2424-2429; Noyes, Intercorporate Relations, sec. 111; Cook, Corp., 7th ed., sec. 670, p. 217, note.

. . . . . .

"It is next argued that the sale here in controversy is void for the reason that the Alice Company could not lawfully acquire and hold title to the stock in the Anaconda Company in which the consideration for the sale was paid.

"Here again the general rule is that while under the circumstances of this case, a sale of all of the property of a corporation could be authorized by the owners of less than all of the stock, for an adequate consideration, *it must be for money only,* for the reason that the minority stockholders may not lawfully be compelled to accept a change of investment made for them by others, or to elect between losing their interests or entering a new company."

McRoberts v. Independent Coal and Coke Co., C. C. A. 8th Circuit (1926), 15 Fed. (2d) 157, 162, follows the *Geddes* case and succinctly states the rule.

People v. Ballard (1892), 134 N. Y. 269, 32 N. E. 54, 17 L. R. A. 737, is a very strong and persuasive authority where a New York corporation conveyed all its assets, consisting of California gold mines, to a California corporation upon consideration of an agreement to pay the debts of the old corporation and the transfer of certain shares of capital stock in the new company. The Court said on page 59:

"While a corporation may sell its property to pay debts, or to carry on its business, it cannot sell its

property in order to deprive itself of existence. It cannot sell all its property to a foreign corporation organized through its procurement, with a majority of nonresident trustees, *for the express purpose of stepping into its shoes, taking all its assets, and carrying on its business. That would be the practical destruction of the corporation by its own act, which the law will not tolerate.* Whether the process by which it was sought to convert the New York corporation into a California corporation is called 'reorganization', 'consolidation', or 'amalgamation', it was the exercise of a power not delegated, and was void. *It was corporate burial in New York for resurrection in California.*"

Mutual Gold did precisely the same thing as this New York corporation. Log Cabin was organized through Mutual Gold's procurement pursuant to contract with Garbutt. It conveyed substantially all its assets to this new corporation, organized for the express purpose of stepping into the shoes of Mutual Gold, taking all its assets and carrying on its business. Log Cabin's directors were nonresident and it was organized under the laws of a different state, thus completing the corporate burial of Mutual Gold. In the case at bar Mutual Gold got even less than the New York corporation, whose debts were paid as part of the consideration.

> "In no case so far as we can find, have the nonconsenting minority been compelled to accept stock in the new corporation, *in the absence of some statute in force when they became stockholders, expressly conferring* that authority. . . ."
>
> *American Seating Co. v. Bullard* (C. C. A. 6th Cir., 1923), 290 Fed. 896, 900.

Theis v. Spokane Falls Gas L. Co. (1904), 34 Wash. 23, 74 Pac. 1004, 1006, cites the rule as expressed in *Cook on Corporations,* Sec. 670, that neither the directors nor a majority of the stockholders have the power to sell all the assets against the dissent of a single stockholder, unless the corporation is in a failing condition. As held by the *Geddes* case, *supra,* in such case the sale can only be for cash. This Court will note here that the District Court stated in its opinion [Tr. 174] that the *Theis* case appears to have been specifically overruled by *Lange v. Reservation Mining & Smelting Co.,* 93 Pac. 208. The *Theis* case turned on the question of the "freezing out" of minority stockholders. The *Lange* case cites the *Theis* case merely to uphold the principle of law that a sale cannot be made where its effect would be to thwart the purposes for which the corporation was organized or destroy the corporation itself, or to "freeze out" minority stockholders. In the *Lange* case the property was sold for cash in nearly the same amount as its original cost. The Court said that the corporation was then in as good a condition so as to proceed with the objects for which it was formed. We submit that this is not a specific or any sort of overruling of the *Theis* case and see nothing in either the *Theis* case or the *Lange* case in contravention of the position taken by appellants herein.

See also:

Garrett v. Reid-Cashion Land & Cattle Co. (Ariz. 1928), 270 Pac. 1044, 1049;

National Association etc. v. United States (Ct. App. D. C. 1923), 292 Fed. 668;

14 *Corpus Juris,* 246, Sec. 2075;

13 *Am. Juris.* 187, Sec. 37.

Inasmuch as the common law rule prohibits the sale of all the assets without unanimous consent of the stockholders of a solvent corporation, or otherwise, if the sale is for cash and the corporation is insolvent or in a failing condition, the ultra vires must exist whether Mutual Gold was solvent or insolvent. The findings are confused in this particular. Finding X [Tr. 184] indicates the company simply needed funds to build a mill. Finding XXXV [Tr. 199] sets forth the debts of the company, a small proporton of which were due and payable. This confusion is immaterial as neither condition of unanimous stockholder approval nor sale for cash is present.

(c) The Washington Act of 1933, passed pursuant to the power to amend corporation laws reserved in the Constitution of the State of Washington, does not control Mutual Gold.

1. Washington follows the minority rule that such a law cannot change or burden the intra-corporation relationship, including said minority stockholder rights relating to sale of assets.

The District Court based its decision erroneously, we submit, upon the alternative proposition that even though the law of 1932 did not authorize the transactions complained of, that the law of 1933 did in Sections 3803-36 Rem. Rev. Stat., hereinafter set forth, and that no vested rights were violated. Washington adopted the general practice of following the suggestion of the *Dartmouth College* case by incorporating into its constitution (Sec. 1, Art. XII) a provision that "all laws relating to corporations may be altered, amended or repealed by the Legislature at any time."

The scope of the power is stated in *Looker v. Maynard ex rel Dusenbury,* 179 U. S. 46, 45 L. Ed. 79, on page 81, in language frequently quoted, as follows:

> "The effect of such a provision, . . . is, at the least, to reserve to the legislature the power to make any alteration or amendment of a charter subject to it, which will not defeat or substantially impair the object of the grant, or any right vested under the grant, and which the legislature may deem necessary to carry into effect the purpose of the grant, or to protect the *rights of the public* or of the corporation, its stockholders or creditors, or to promote the due administration of its affairs."

But such reserved right to alter or amend the corporation laws, and thus the charter of any corporation formed thereunder, has very real limitations. As stated in 12 *Corpus Juris,* Sec. 537, p. 969, the legislature may not under such reserved power divest property or vested rights.

The fountainhead of this rule is the often quoted statement of the United States Supreme Court in *Shields v. Ohio,* 95 U. S. 319, 324, 24 L. Ed. 357, 359, as follows:

> "The power of alteration and amendment is not without limit. The alterations must be reasonable. They must be made in good faith, and be consistent with the scope and object of the Act of incorporation. Sheer oppression and wrong cannot be inflicted under the guise of amendment or alteration. Beyond the sphere of the reserved powers, the vested rights of property of corporations in such cases are surrounded by the same sanctions and are as inviolable as in other cases."

As said in *Hill v. Glasgow R. Co.* (Cir. Ct. D. Ky. 1888), 41 Fed. 610, at 616:

> "All rights thus acquired, of whatever character, are surrounded and protected by constitutional sanctions and guaranties higher and superior to the legislative power of amendment or repeal."

To the same effect:

> *California Corporation Laws,* 1938 ed. *Ballantine and Sterling.*

The authorities are in conflict as to what rights are vested or of such nature as to require this protection. The *majority* view permits control of the internal management of the corporation so as to burden the stockholders by increasing their liability, diminishing the value of their stock, or changing the stock as to amount, kind and classification. Therefore the majority rule permits turning nonassessable stock into assessable stock, or changing the relative status of classes of stock as in the following cases:

In *Security State Bank v. Sharpe* (Minn. 1927), 212 N. W. 801, an assessment was upheld designed to make good an impairment of capital assets of a Montana bank.

Sommerville v. St. Louis Mining & Milling Co. (Sup. Ct., Mont. 1912), 127 Pac. 464, is a strong case relating to the stock of a mining corporation which recited on its face that it was nonassessable.

Hinckley v. Schwarzschild & Sulzberger Co. (1905), 107 A. D. 470, 95 N. Y. Supp. 357, permitted preferred stock not authorized when the common stock was issued.

These cases seek to justify this interference with the contract of the stockholder by stating it is of public interest or in furtherance of public policy to alter the intra-corporate relationship, thus coming within the rule that limits changes to those of public interest, or those powers which the state has granted. See: *Morawetz, Corporations,* 1097, and 1 *Rose's Notes,* p. 942.

Montana adheres to the majority view. In a case involving the sale of a mine, to wit, *Allen v. Ajax Mining Co.* (Supreme Ct., Mont., 1904), 77 Pac. 47, the National Property and Development Company, a going concern, purchased all the property of the Ajax Mining Company, paying therefor forty per cent of its capital stock. The Court held that although at the time of the formation of the Ajax Company the majority stockholders could not dispose of the assets, that the law existing at the time of the transfer so permitting was lawfully adopted pursuant to the reserve power. It said that the test was that if the regulation for the management, operation or control of the corporation could have been inserted upon its organization, it could be engrafted upon the company later.

In *Germer v. Triple-State Natural Gas & Oil Co.* (Supreme Ct. of Appeals, W. Va., 1906), 54 S. E. 509, the selling corporation received one-third of the stock and the purchasing corporation paid off obligations of the selling corporation and in addition issued stock for working capital. The Court held that the sale fell within the majority rule, citing *Allen v. Ajax Mining Co.,* 77 Pac. 47, and cases dealing with assessments.

The *minority* view with respect to assessments and like interference with intra-corporate matters appears in the

long and well-reasoned case of *Garey v. St. Joe Mining Co.* (Supreme Ct., Utah, 1907), 91 Pac. 369), where the articles were amended to render the stock assessable. The Court quotes at length from authorities, including the text writers. This case emphasizes the dual contract—that of the state and the corporation and its stockholders, and that between the corporation and its stockholders. It views the act passed under the reserve power as an interference with the very core of contractual relations of the stockholders among themselves.

Other minority view cases are as follows:

Snook v. Georgia Improvement Co. (Supreme Ct., Ga., 1889), 9 S. E. 1104, changing termini of a railroad.

Oneal v. Mann (Supreme Ct., N. Car., 1927), 136 S. E. 379, changing the liability of lands in a drainage district.

Hill v. Glasgow R. Co. (Circuit Ct., D. Ky., 1888), 41 Fed. 610, diverting proceeds of railroad income to a portion of the stockholders.

In *State v. Neff* (Supreme Ct., Ohio, 1895), 40 N. E. 720, Cincinnati college was an institution whose property grew out of private donations. Its control and management and all of its property was placed by statute under the control and management of the University of Cincinnati. The Court held that its property was private as distinguished from public, notwithstanding it administered a public charity and that such property was within the protection of the constitution.

In re Mt. Sinai Hospital (Ct. of App., N. Y., 1928), 164 N. E. 871, 875, holds that subsequent legislation may change the voting rights of the trustees of a charitable

corporation and may be classed with the majority, but we include it with the minority cases in view of the following strong dictum:

> "Appellants are not asserting the right of the corporation to prevent the *transfer of the corporate property* from one board of trustees to another by the creation of a new corporation under a new charter, Ohio ex rel. v. Neff, 52 Ohio St. 375, 40 N. E. 720; Sage v. Dillard, 15 B. Mon. (Ky.) 340, 360; Regents of University of Maryland v. Williams, 9 Gill & J. (Md.) 365, 31 Am. Dec. 72, *for no such transfer is attempted.* . . . The voting power was exercised by the members for the benefit of the corporation. Appellants have no beneficial interest of their own to protect (Matter of Morse, 247 N. Y. 290, 303, 304, 160 N. E. 374, 378); . . ."

Moore v. Los Lugos Gold Mines (1933), 172 Wash. 570, 21 Pac. (2d) 253, involved stock of an old company, which was nonassessable, transferred for stock in a new company which was assessable. This case upholds the minority view and applies it to the transfer of assets, and is fully analyzed below.

The minority rule in dealing with the sale of assets is vigorously set forth in the case of *Garrett v. Reid-Cashion Land & Cattle Co.* (1928), 34 Ariz. 245, 270 Pac. 1044, which is extensively quoted by the Washington court in *Moore v. Los Lugos, supra.* This case involved the transfer of all the corporate assets and held that this could not be accomplished without unanimous stockholder consent, saying on page 1049:

> "If the law at the time one becomes a stockholder in a corporation does not invest the majority of the stockholders with the power to sell the entire assets of

the corporation, or to exchange its assets for stock in another corporation, and its articles of incorporation do not give such authority, the exercise of it by a majority of the stockholders against a nonconsenting stockholder cannot legally be done."

We turn now to the State of Washington, which follows the minority rule. *Moore v. Los Lugos, supra,* 21 Pac. (2d) 253, is the leading case. This involved changing nonassessable stock to assessable stock. The old company was in financial distress and unable to pay taxes on its Mexican property and other debts. One, Wilson, proposed a transfer to him of all the assets of the old company to be used in the organization of a new company under the laws of the State of Washington, to which new company all the assets should be transferred and it in turn to pay the debts of the old company and a bonus to Wilson. The shares in the new company were to be assessable and were to be exchanged for shares of stock in the old company. The board of trustees unanimously voted to accept this offer. No point was made by the Supreme Court of the failure to obtain unanimous stockholder approval. It went off on the question of the validity, making nonassessable stock assessable. The Court disapproved of the transaction, quoting with approval from the cases of *Geddes v. Anaconda Copper Mining Co.,* 254 U. S. 590, 65 L. Ed. 425; *Theis v. Spokane Falls Gas Light Co.,* 34 Wash. 23, 74 Pac. 1004, 1006; *Whicher v. Delaware Mines Corp.* (Idaho), 15 Pac. (2d) 610, 612; *Garrett v. Reid-Cashion Land &*

Cattle Co., 34 Ariz. 245, 270 Pac. 1004; and *People v. Ballard,* 134 N. Y. 269, 32 N. E. 54, 59, 17 L. R. A. 737. The Court said on page 259:

> "The trustees of the old and the new companies were powerless to assess the nonassessable shares of stock of the stockholders of the old company. *In fact, a statute authorizing assessments to be made on that stock would be invalid.* 'It may be laid down as a rule that a statute authorizing assessments to be made on existing full paid stock is unconstitutional and void as to existing stockholders. This is on the theory that the existing laws become a part of the stockholder's contract of subscription, and that this contract cannot be impaired by any subsequent legislation.' "

The Supreme Court of Washington by approving the *Garrett* case, *supra,* and quoting the language we have quoted *supra* therefrom, adopted the minority view with respect to transfer of assets as well as in stock assessment and the like.

2. The 1933 Act does not apply because Mutual Gold has not amended its articles as required by the Act itself in order to render the section covering sale of assets applicable.

If it could be held contrary to our contention that the reserved power to amend sustains the 1933 Act as against the rights of the stockholders, and creditors, we confidently submit that still the act is not applicable because Mutual Gold did not amend its articles to include the

provision authorizing sale of all the assets. That section is 3803-36, *Remington Revised Statutes,* as follows:

> "1. A voluntary sale, lease or exchange of all the assets of a corporation may be authorized by it upon such terms and conditions as it deems expedient, including an exchange for shares in another corporation, domestic or foreign.
>
> "2. If the corporation is able to meet its liabilities then matured, such authorization shall be given at a meeting of shareholders, duly called for the purpose, and by such vote of the shareholders as may be provided for in the articles of incorporation or, if there be no such specific provision, then by the vote of the holders of two-thirds of the voting power of all shareholders. If the corporation be unable to meet its liabilities then matured, such authorization may be given by the vote of the board of directors.
>
> "3. This section shall not be construed to authorize a conveyance or exchange of assets which would otherwise be in fraud of corporate creditors or of minority shareholders or shareholders without voting rights. (L. '33, Sec. 36, p. 798.)"

Said section is entirely new. It is not in the Washington laws as previously existing and it is a radical departure from and contradiction to the common law rule. The section is immediately followed by Sec. 3803-37 as follows:

> "1. A corporation may, at meeting of the shareholders duly called *upon notice of the specific purpose,* and *in the manner herein provided,* amend its articles in any respect so as to *include any provision authorized by this act,* or so as to extend the period of its duration for a further definite time or perpetually.

"2. An amendment changing the name of the corporation may be adopted by the vote of the holders of a majority of the voting power of all shareholders, or by such vote as the articles of incorporation require.

"3. An amendment altering the articles of incorporation in any other respect may be adopted by vote of the holders of two-thirds of the voting power of all shareholders, or by such vote as the articles of incorporation require.

"4. If an amendment would make any change in the rights of the holders of shares of any class, or would authorize shares with preferences in any respect superior to those of outstanding shares of any class, then the holders of each class of shares so affected by the amendment shall be entitled to vote as a class upon such amendment, whether by the terms of the articles of incorporation such class be entitled to vote or not, and, in addition to the vote required by subdivision 3 of this section, the vote of the holders of two-thirds of the shares of each class so affected by the amendment shall be necessary to the adoption thereof.

"5. Any amendment which might be adopted at a meeting of (a) shareholders as provided in this section, may be adopted without such a meeting being held if written consent to the amendment has been given by all shareholders entitled to vote thereon as provided in this section. (L. '33, Sec. 37, p. 798.)"

If all the provisions of the 1933 Act were automatically included in the charters of preexisting corporations, including a new and radical departure such as Section 36, then Section 37 would be meaningless. Permission is

given to any corporation to amend its articles so as to "include" any provision authorized by the new act. This has no reference to changing or abandoning a contrary portion of the articles but uses the word "include" meaning thereby that where the articles do not already contain any given provision of the new act the same may be added by amendment. The legislature in effect has thereby said that the rights of the stockholders shall not be changed in this vital particular unless two-thirds of them determine to take advantage of the new provision. Mutual Gold could not therefore sell its assets by two-thirds vote of its stockholders or by vote of its directors. The sale itself, even though it might be by a two-thirds vote of the stockholders, as was the purported authorization of the September 2, 1938 contract, is of course not equivalent to such amendment.

Acceptance of an amendatory provision is essential particularly when, as in the Washington law, it is expressly required. The only exception is in the case of amendments relating to police power or eminent domain. The state can no more compel corporations to accept an amended charter than it could compel them to accept the original charter. Acceptance of some of the powers only is properly authorized by an amendatory act.

18 *Corpus Juris Secundum,* pp. 475, 476, Sec. 81a.

3. The remedy given by the 1933 Act to dissenting stockholders cannot be forced upon them and render a void act valid.

The District Court seeks to justify the applicability of the Act of 1933 in its opinion at transcript 173 by stating that if the plaintiffs in the case are dissatisfied with a

resolution they had their remedy under Sec. 3803-41, *Rem. Rev. Statutes,* which provides for the valuation of shares and the payment thereof to a dissenting minority. This we submit is tantamount to saying that the 1933 Act is lawful simply because it gives a remedy to the minority. Such remedy could not make legal a section to be tested by constitutionality and other measuring sticks. If the right is vested the legislature cannot take it away and give something in its place. In any event the remedy would be unavailing and insufficient. Cash was not involved in Mutual Gold's transaction and a judgment against that corporation, pursuant to the provisions of the section would be a highly speculative advantage and would probably produce nothing as the shares of Log Cabin were not equivalent to cash.

Not Only Was the Transaction Not for Cash or Its Equivalent, but the Consideration Was Wholly Inadequate.

As so aptly stated in *Whicher v. Delaware Mines Corp.* (Idaho, 1932), 15 Pac. (2d) 610,

> " 'To otherwise dispose of' does not signify and include 'to give away'. . . ."

This case is quoted at length and with approval in *Moore v. Los Lugos, supra,* 21 Pac. (2d) 253.

Geddes v. Anaconda Copper Mining Co., supra, 65 L. Ed. 425, 431, emphasizes the necessity of adequate consideration.

That Mutual Gold got nothing tangible or adequate through stock ownership in Log Cabin is clear when we consider that Log Cabin could not operate the mine on

its capitalization and was nothing more or less than Garbutt. It was virtually his *"alter ego"*. He organized it, selected the majority of its directors at all times, was promoter, principal creditor, manager, majority stockholder and trustee [Findings XX, XXIII, Tr. 193, 194]. It had no assets from its organization on October 18, 1938 to March 10, 1939 [Finding XXX, Tr. 197]. From September 2d to November 1, 1938, he operated for himself, then for Mutual Gold until the December 17, 1938 contract went into effect [Tr. 761], and then for Log Cabin. Under the September 2, 1938 contract he had the right to fix the capitalization and he did so at the low figure of $10,000.00. It was so completely Garbutt's creature that, during the period of his operation of the mine and even after Log Cabin was organized, he did not take the trouble to make any distinction in his records as to who was operating, whether Mutual Gold, Log Cabin, Garbutt as trustee, or otherwise [Tr. 558, 377]. His bank accounts were likewise subject to the same confusion. His superintendents were paid by personal checks [Tr. 374, 389]. During the entire operation $100.00 a month expense was charged for office work without any segregation as between regimes. Again, he regarded Log Cabin as himself, and himself as Log Cabin, in connection with the quiet title suit in Los Angeles County, brought by Log Cabin, which he engineered to bolster the title to the purchase contract, even planning who should be parties to the action. This followed a quiet title suit commenced in the State of Washington by A. P. Bateham, chairman of the stockholders' protective committee. In the Bateham suit, Grill and two other directors of Log Cabin Mining Co., who stood with Garbutt, had resigned from the board of directors of Mutual

Gold so that they could not be served with process [Tr. 482, 483] and the Bateham suit did not go to judgment. The correspondence between Garbutt and Grill and testimony relating thereto and to the Garbutt quiet title suit appears at transcript pages 470-483, 554, 601-603. Mutual Gold's decision not to contest this action was put over hurriedly by the board of directors with no debate [Tr. 658] and with some confusion as to whether it was brought by Garbutt or Log Cabin [Tr. 659]. The resolution to make no defense referred to "the action of Mr. Garbutt brought to quiet title to said claims in the Log Cabin Mines Company" [Tr. 659]. Thus Log Cabin had practically nothing but the gold mine, was Garbutt's creature corporation and Garbutt undertook virtually nothing except as he might determine to be advantageous.

Moore v. Los Lugos, supra, 21 Pac. (2d) 253 also gives the *coup de grace* to another early Washington case relied upon by the District Court in the case at bar as authority, namely, *Pitcher v. Long Pine-Surprise Consolidated Mining Co.* (1905), 39 Wash. 608, 81 Pac. 1047. The District Court quotes from this case at transcript 175-176. The Washington Supreme Court distinguishes this case in *Moore v. Los Lugos,* at page 263, in the following words:

> "Pitcher v. Lone Pine-Surprise Consolidated Mining Co., 39 Wash. 608, 81 P. 1047, 1049, cited by respondents in support of their position, and upon which the trial court relied, is not in point. *All that was held in that case* was that one, who, after a corporate sale of property, purchased for not more than $25 shares of stock of the corporation making the sale, would not be permitted to maintain an action to set aside that sale. We said: 'It is urged by respond-

ents that appellant has no standing that permits him to question the sale of this property. He was not a stockholder at the time of the transactions complained of. He bought the stock he now has for the evident purpose of bringing this action."

In this connection we call the Court's attention to *Logie v. Mother Lode Copper Mines* (1919), 106 Wash. 208, 179 Pac. 835, characterized by the District Court as authority for its decision [Tr. 174]. This case was called to the Court's attention in *Moore v. Los Lugos, supra,* and overruled in the following language:

> "In Logie v. Mother Lode Copper Mines Co., 106 Wash. 208, 179 Pac. 835, 839, the mining company was authorized by its articles of incorporation to purchase and acquire real and personal property, and to sell and alienate the same. We held that, under the statute (Rem. Code, 1915, Sec. 3684) authorizing a corporation to acquire, by purchase or otherwise, and to own, hold, sell and transfer shares of stock of any other corporation, the corporation might sell all, or substantially all, of its corporate property and lawfully receive, in consideration therefor, stock in another corporation. *The adequacy of the consideration was not questioned. No constitutional question was raised.*"

A little further on, at page 264, the Washington court, crushing in plain words any lingering faith that might otherwise be pinned on the *Logie* case, took occasion to say:

> "It may be that language in some of our opinions permits of interpretation favorable to the position of the respondents. If so, those cases are overruled in

so far as aught appears therein sustaining or tending to justify transactions like those out of which this action arose."

Not only is *Logie v. Mother Lode* overruled by *Moore v. Los Lugos,* but its facts are a clear basis for distinction. The language above quoted itself suggests the distinguishing feature in these words:

"The adequacy of the consideration was not questioned. No constitutional question was raised."

In the *Logie* case, decided in 1919, there was a sale of substantially all the assets of the Mother Lode Copper Mines Co., a Washington corporation, whose articles authorized it to acquire, hold, or alienate its properties in the same manner and to the same extent as any actual or artificial person and to own stock in other corporations. Its mining properties were about fourteen miles from railway transportation to the Alaskan coast, the inland termination of which line was the location of the Kennecott Mines owned and operated by the Kennecott Copper Corporation. This latter company had a large, well-equipped concentration plant and was separated from the defendant's claims by a high mountain range. Defendant had no means of transportation except to truck fourteen miles to the railroad and it had no concentration plant. It could not develop its properties adequately without concentration and cheaper transportation. It did not have sufficient means to meet such expenditures and owed substantial sums in addition to a bonded indebtedness. A contract between the defendant and one Birch, the president of the Kennecott Copper Corporation was entered into whereby a new corporation was to be organized, the

defendant to convey its properties to the new corporation subject to its bonded indebtedness, in consideration of which 1,225,000 shares of the new company would be issued to the defendant and 1,275,000 shares to Birch, or to his nominees, said stock constituting all the stock of the new corporation. The further consideration was that Birch should contemporaneously deliver the $550,-000.00 necessary to redeem defendant's outstanding bonds, pay organization and taxation expenses and a further sum not exceeding $1,000,000.00 as in the judgment of Birch (exercisable of course in good faith) might be necessary for sufficient working capital, and the new company was to have the benefit of the same smelting, refining, freight and selling charges as the Kennecott Copper Corporation.

The difference between these facts and those at bar are sweeping. Mutual Gold's outstanding indebtedness, including production notes, are not paid off, no advantages of transportation, concentration or other operative matters accrue to Mutual Gold except as they might follow the advancement of money at the whim and caprice of Garbutt, who might at any time withdraw from the contract. The theory of the plaintiff below, which is reflected in the opinion of the District Court [Tr. 170-178] is that the contract should be upheld because it was a favorable contract, or at least worked out favorably, as the defendants allege, for the old corporation Mutual Gold. But the failure of consideration must be determined at the time it was made and not in the light of subsequent events. Suppose he had paid the $10,000.00 and immediately withdrawn. Could any one contend that Mutual Gold had received an adequate consideration for the complete loss of its valuable mine, which under the low valua-

tions alleged in Garbutt's answer had 63,500 tons of ore worth $650.000.00 then developed and $68,000.00 of other assets [Tr. 123, 124], and out of which subsequently came 48,500 tons worth $265,000.00 [Finding XXXVIII, Tr. 201]. As stated in *Citrus Growers Development Association v. Salt River V. W. Users Assn.* (Ariz., 1928), 268 Pac. 773, at 776:

> "Neither can the fact that the alteration is beneficial give the majority the power to accept it against the dissent of the minority."

The Court will also note the following case which disregards the supposed advantage to a corporation in the face of the violation of constitutional guarantees.

> *Irving Trust Co. v. Deutsch* (1932), 2 Fed. Supp. 971; 73 Fed. (2d) 121 (2d Cir.)

The majority view cases above cited involving sales of assets, namely, *Germer v. Triple-State Natural Gas & Oil Co.,* 54 S. E. 509, and *Allen v. Ajax Mining Co.,* 77 Pac. 47, likewise may be distinguished on the facts in view of a substantial consideration accruing therein to the selling corporation.

In the *Germer* case, the new corporation issued $3,000,000.00 in a consolidated mortgage on the property the company acquired and the new company agreed to discharge all liabilities, contracts and obligations of the selling corporation, including issuance of certain new bonds to take up the old. Certain of the bonds and stock of the new corporation were to be sold for the substantial sum of $1,249,000.00 in cash into the treasury of the new company. In *Allen v. Ajax Mining Co.,* the old company was to receive only forty per cent of the capital stock of the new company.

(d) The new legislation may not authorize such a fundamental change in the charter of a corporation as here attempted.

The new legislation may not authorize such a fundamental change in the charter of a corporation as to divert it from its original contract and purposes.

18 *Corpus Juris Secundum* p. 477, Sec. 81b (3).

McKenzie v. Guaranteed Bond & Mortgage Co. (Ga., 1929), 147 S. E. 102, involved an increase of stock of a bond and mortgage company. This, said the Court, without consent of all the stockholders, would make them members of an association to which they had never consented and that even distribution of stock pro-rata would often work injustice because many of the stockholders might be unable to take their respective shares.

See also:

Macon Gas Co. v. Richter (Ga., 1915), 85 S. E. 112.

In re Mt. Sinai Hospital, supra (N. Y. 1928), 164 N. E. 871, 874, states the rule as follows, quoting from the Supreme Court of the United States:

> "Any alteration may be made 'which will not defeat or substantially impair the object of the grant, or any rights * * * vested under it, and which the legislature may deem necessary to secure either' that object 'or any public right' or 'to promote due administration of the affairs of the corporation'. Tomlinson v. Jessup, 15 Wall. 454, 21 L. Ed. 204; . . .

'The alterations (under the reserved power) must be reasonable; * * * and be consistent with the scope and object of the act of incorporation.' Shields v. Ohio, 95 U. S. 319, 324 (24 L. Ed. 357); . . ."

(e) The Garbutt contracts are void because no provision is made to take care of the creditors of Mutual Gold.

An examination of the various contracts with Garbutt show that no provision was made for creditors of Mutual Gold. This was deliberate. It was discussed with Garbutt as to whether the September 2d agreement should take care of the situation and it was decided to make no provision for creditors [Tr. 467, 468].

The creditors of Mutual Gold and the amounts owing are set forth in paragraph III of plaintiff's bill of particulars [Tr. 105-110 and Finding XXXV, Tr. 199]. The claims were $30,000.00 by way of production notes and in excess of $25,000.00 on open accounts, in addition to the installment of $10,000.00 due on the purchase price November 1, 1938.

At the eleventh hour and long after the transactions complained of, to wit, on August 23, 1939, which was the eve of the trial of certain lawsuits in the State of Washington brought by Vance and others against Mutual Gold, upon open accounts and production notes, a contract was made between Mutual Gold, Garbutt and Log Cabin providing that after repayment of the amounts advanced by Log Cabin and other expenses, the net proceeds accruing to Mutual Gold should first be paid to discharge said indebtedness. This contract may be disregarded so far

as the question of *ultra vires* in connection with creditors is concerned because it was executed long after the contracts and other transactions complained of and falls far short of achieving any desired end so far as creditors are concerned. The only way Mutual Gold could have any money to devote to creditors would be through dividends on its minority interest, and Log Cabin as controlled by Garbutt, might or might not declare such dividends.

The assets of an insolvent corporation are a trust fund for its creditors and stockholders. *Wells & Wade v. Unity Orchards Co.* (1936), 186 Wash. 198, 204, 57 Pac. (2d) 1050, 1052. At page 1052 the Supreme Court of Washington said:

> "The law is well settled that, in the reorganization of a corporation—no judicial sale of respondent's property was ordered—such as that attempted in the case at bar, *each creditor has superior rights against the stockholders of the corporation* . . .
>
> ". . . Section 63, p. 814, of the act clearly states that the legislature did not intend that the act should affect or impair any liability acquired prior to its enactment." (Italics ours.)

Jones v. Francis (1912), 70 Wash. 676, 127 Pac. 307, which cites *Northern Pacific R. Co. v. Boyd* (1913), 228 U. S. 482, 57 L. Ed. 931, the leading Federal case on the protection of creditors.

In *Hill v. Brandes* (1939), 1 Wash. (2d) 196, 95 Pac. (2d) 382, it was said at 384:

> "A domestic corporation cannot after insolvency prefer one or more of its creditors. Its property is, after insolvency, regarded as a trust fund for all of its creditors, and any payments or transfers of prop-

erty made after insolvency, which have the effect of preferring one creditor over another are void . . ." (Citing cases.)

Moore v. Los Lugos, supra, 21 Pac. (2d) 253, at 264 dismissed cases cited against the Court's position with the following statement:

> "All of the cases cited however, presuppose a valid sale for the purpose of paying the indebtedness of the corporation."

(f) The acts complained of cannot be confirmed. To do so would impair the obligations of the contracts of stockholders and creditors of Mutual Gold and deprive them and the corporation of property without due process of law.

If this Court were to confirm the acts performed or attempted to be performed whereby Mutual Gold was deprived of its assets, it would impair the obligation of contracts of the stockholders and creditors in violation of Sec. 10 of Art. 1 of the United States Constitution and of Sec. 23 of Art. I of the Washington Constitution. It would deprive them also of their property without due process of law, in violation of the Fourteenth Amendment to the United States Constitution, and Sec. 3 of Art. 1 of the Washington Constitution. Additional cases on the constitutional doctrine are as follows:

Coombes v. Getz (1932), 285 U. S. 434, 76 L. Ed. 866;

Ettor v. Tacoma (1913), 228 U. S. 148, 156, 57 L. Ed. 773, 778.

In the *Coombes* case, *supra,* the action was brought by creditors against directors for embezzled monies. Pending appeal the constitutional provision was repealed. The Supreme Court of the United States held that such repeal could not divest plaintiffs of their cause of action and to hold otherwise would be a violation of Section 10 of Art. I and of the due process clause of the Fourteenth Amendment. The *Ettor* case, *supra,* contains a similar ruling in connection with a statute of the State of Washington requiring municipalities to compensate for consequential damages arising out of condemnation proceedings.

(g) The transactions are void since they turn the corporation into a shell and result in an abnegation of its powers.

Passing the question of reserved power to amend or the applicability of the 1933 Act, we will examine the nature of the transaction for its effect upon the corporation as such. The facts do not need reiteration here. Suffice it to remind the Court that before the transaction Mutual Gold had a valuable mine, thereafter it had no control of its property and had divested itself of the title. It had virtually ceased to function. The sale of the assets in any event could not be upheld if it amounts to a device to turn the corporation into a shell and abrogate its powers.

Ultra vires is something more than the violation of express provisions of law. As was said in *State v. Corning State Savings Bank* (Supreme Ct., Iowa, 1907), 113 N. W. 500, 503, where it is said:

> ". . . *ultra vires* contracts of a corporation are . . . contracts not positively forbidden, but impliedly forbidden, because not expressly or impliedly authorized."
>
> *Barry v. Interstate Refineries* (D. Ct. W. D., Mo. W. D., 1926), 13 Fed. (2d) 249.

The charter of a corporation such as Mutual Gold is a measure of its powers, and enumeration of certain powers implies the exclusion of all others. *Thomas v. West Jersey Railroad Co.* (1880), 101 U. S. 71, 81, 82, 25 L. Ed. 950, 951, 952; *Thompson on Corporations* (3d ed), Vol. 3, Sec. 2175.

From *Moore v. Los Lugos Gold Mines, supra,* 21 Pac. (2d) 253, it appears that the authority vested in the board of trustees does not extend beyond the management of ordinary corporate affairs.

In 19 *Corpus Juris Secundum* at page 669, it is said:

> "In the absence of express authorization, a corporation cannot transfer all of its property to another corporation for the purpose of enabling the transferee to exercise its powers and control its affairs."

In point under the above heading is the following from *Seattle Investors Syndicate v. West Dependable Stores, etc.* (1934), 177 Wash. 125, at 127, 30 Pac. (2d) 956, at p. 957, col. 2:

> "As appears, the appellant purchased the capital stock and assets of the Red Robin Stores, operated

the business thereafter, and paid the stockholders of the Red Robin Stores in stock of the new corporation. *The Red Robin Stores, while its corporate existence was not destroyed was nothing more than a shell.*" (Italics ours.)

In *McCutcheon v. Merz Capsule Co.* (C. C. A. 6th Cir., 1896), 71 Fed. 787, the Court stated, on page 793:

> "The avowed object was to continue corporate life and activity through the instrumentality of another corporation. There was to be a corporation within a corporation. Individual activity was to cease, but corporate energy was to be exercised through a living corporation, whose life and functions were to be controlled through the shares held by its corporate creator and master. . . . The effect of this action of the appellee was to divest itself of the power to exercise the essential and vital elements of its franchise, by a renunciation of the right to engage directly and individually in the *very business* which it was organized to carry on, and is a disregard of the conditions upon which corporate existence was conferred."

See also:

People v. Ballard, supra, 134 N. Y. 269, 32 N. E. 54.

In this connection we refer to the case of *Child v. Idaho Hewer Mines* (Wash., 1930), 284 Pac. 80, cited by the District Court at transcript 175 as sustaining its holding. This case is clearly distinguishable on its facts. It deals with assessment of stock pursuant to express power included in the articles and the by-laws and on the face of the stock certificate itself. It is true that the articles

of Mutual Gold permit the sale or exchange of corporate property in general terms. However, they do not provide for, nor in any manner permit, the sale of all the assets in contravention of common law principles protecting vested rights, nor for the grossly inadequate consideration of $10,000.00 plus Garbutt's unilateral undertaking; particularly since the corporation loses the control and management of its assets, all of which constitutes an abnegation of its foundamental purposes.

(h) The articles of Mutual Gold do not contain any authorization of the transaction complained of.

The District Court in its opinion [Tr. 175] reads into sub. (b) Article 2 of the Articles of Mutual Gold giving the right "to sell, exchange, lease or in any other manner dispose of the whole or any part thereof" [Tr. 210], authority to make the transfer in question. This language is very general and cannot be held to authorize anything other than a valid sale pursuant to legal principles which, as we have seen, was limited by the common law to unanimous stockholder action or a sale for cash.

We have seen that to "otherwise dispose of" does not mean "to give away." *Whicher v. Delaware Mines Corp., supra,* 15 Pac. (2d) 610.

In *Geddes v. Anaconda Copper Mining Co., supra,* 65 L. Ed. 425, 431, the articles gave "authority to buy, sell, lease, hold and operate mines." The Court nevertheless applied the limitations.

Illegality.

The Mutual Gold Transfer of Assets Was Illegal and Void Because No Adequate or Legal Notice Was Given to Stockholders of the Proposed Action.

Irrespective of the *ultra vires* of the transaction the contracts and ensuing conveyances were illegal and void for the reason that the purported authority by Mutual Gold was improperly and insufficiently executed. The notice, the proxy solicited, and the president's letter relating thereto for the stockholders' meeting of August 6, 1938, were defective in that the purpose of the meeting was not stated. A reference to the Vance contract was coupled therein with general language which would authorize the corporation to make any other deal by way of sale or transfer of the assets that the directors in their discretion should determine. This is not notice that the corporation would sell all its assets in the illegal and improper manner that eventuated. The Vance contract provided for the sale of half the assets, payment of creditors, and a firm commitment for financing, and any other contract of the same nature with any other person would not cover a sale of all the assets or for an inadequate consideration or under circumstances including abnegation of corporate functions. After the September 2, 1938 contract was entered into there was no attempt to secure stockholder approval. The meeting called for that purpose was cancelled. The November 1, 1938, contract was not laid before the stockholders.

The contract of December 17, 1938, finally fixed the relationship of the parties and is purportedly in effect today. It took the place of the agreement of November 1, 1938, just as that contract superseded that of September 2, 1938. This contract was purportedly approved by the stockholders but the notice of the meeting held February 1, 1939, contained no mention of this agreement [Tr. 606]. The proxy solicited by the management likewise made no mention of it [Tr. 607].

Section 3 of Article I of the by-laws of Mutual Gold [Tr. 218] specifies machinery for notices *in addition to the notice required by law.* The by-law mentions stating the objects for a special meeting, but Section 3803-27, Remington, Revised Statutes, subsection 4, provides as follows:

> "4. Persons authorized to call *shareholders' meetings* shall cause written notice of the time, place *and purpose* of the meeting to be given all shareholders entitled to vote at such meeting, at least ten days prior to the day named for the meeting."

The December 17, 1938 contract, which expressly took the place of the preceding agreements, was therefore improperly adopted for failure to state the purpose thereof in the call for the shareholders' meeting. The former contract does not come alive. It is familiar doctrine that a previous contract is not revived when the later contract falls to the ground. Pursuant to the December 17th contract Log Cabin obtained its title to the assets and its

stock was issued. This whole transaction is therefore void.

If the stockholders' meetings purporting to authorize a corporate conveyance are held on insufficient notice the conveyance is a nullity.

Hanrahan v. Andersen (Supreme Court, Mont., 1939), 90 Pac. (2d) 494, 500;

Northern Mining Corp. v. Trunz (C. C. A., 9th Cir., 1941), 124 Fed. (2d) 14, citing with approval

Hanrahan v. Andersen, supra.

Even where no notice is required if one is given it has the effect of limiting the business to be transacted.

Synnott v. Cumberland Bldg. Loan Assn. (C. C. A., 6th Cir., 1902), 117 Fed. 379, 384.

Even if no notice is required, when unusual business is to be transacted the notice should state the unusual business.

Dolbear v. Wilkinson (1916), 172 Cal. 366, 156 Pac. 488, quoting 2 *Cook on Corporations* (6th Ed.), Sec. 595.

Business Compulsion.

The Contracts Pursuant to Which Mutual Gold Transferred Its Assets and the Transfer Itself Are Void or Voidable Because Induced by the Business Compulsion of Garbutt.

(a) Garbutt, acting as representative of the owners of the mining claims, forfeited the purchase contract relating thereto and thereby forced and induced Mutual Gold to enter the transactions complained of.

Garbutt, after attempting to get financial help from a former associate, William C. DeMille, pursuant to a contract that Garbutt himself drew, and failing in another direction, decided to take the entire acquisition of the mine himself [Tr. 528-530, 562]. The transcript covers in some detail the negotiations whereby Garbutt secured control and operation of the mine for himself, but it will not be necessary to direct the Court's attention particularly thereto. Directors Collins, Ferbert and Grill, who was also attorney for Mutual Gold, were particularly active. Garbutt had effective assistance from Keily, superintendent at the mine and his intimate associate who went to Washington to see the directors. Keily had received $300.00 per month from Garbutt for seventeen years. Incidentally, Keily gratefully made Garbutt his heir [Tr. 340, 529, 530, 560, 561, 750, 754].

Garbutt represented the owners in negotiating the original sale of the mining claims to the assignors of Mutual Gold, one of whom was Director Collins, and acted in an advisory capacity to the owners from the very

first [Tr. 5, 23, 530, 748, 749]. In this capacity he had an opportunity to keep in touch with the mine [Tr. 529]. In fact he was the agent of the owners with full power to declare a forfeiture of the purchase contract, as was confirmed by the owners themselves on October 3, 1938, in the fourth cancellation notice [Tr. 314].

We thus have the astounding and disturbing sight of an owner's representative negotiating with a purchaser of mining claims which was in trouble, in order to obtain for himself a majority interest in said claims and the operating rights thereto. The power to force the purchaser to deal was at hand and Garbutt proceeded to exercise it.

The first cancellation letter was that of August 25, 1938 [Tr. 278], received at the board meeting of August 27, 1938, at the height of the negotiations, and was an inducement to the contract of September 2, 1938 [Tr. 383, 384]. It is significant that the first paragraph states that "we" have elected to cancel and that the action "is final and absolute". But the second paragraph expresses concern for the stockholders and invites the company to negotiate with the undersigned (Garbutt), "who will give the matter consideration, provided your defaults are cured and other points of difference are adjusted to his satisfaction".

The cancellation letter of September 2, 1938, written on the date of the first contract, is a masterpiece of subtlety. It reiterates the alleged defaults, frankly states that Garbutt, who signs the letter, has been negotiating with Mutual Gold for a contract looking to the operation of the property, but with no desire to undertake such responsibilities, the only consideration being to give the stockholders an alternative to escape the "manifestly tricky and

unfair contract" that Vance was attempting to force upon them. The letter ended with assurance of friendly feelings from both owners and the writer, a statement that the writer's first duty was to the owners whom he represented, and urging the stockholders to proceed against Vance if the forfeiture became effective [Tr. 279-284]. This last threat to force Vance and his associates into line was unsuccessful, but the repeated threats of forfeiture had the desired effect and the contract was signed and subsequently ratified.

The third cancellation letter was dated September 9, 1938, a week after the signing of the first contract [Tr. 288-291]. This was apparently prompted by a letter from Vance declining to accept cancellation and stating that the company had performed its contract. The former cancellation was reiterated, together with a refusal to negotiate until a letter was received giving the reasons for enumerated breaches. Although he had inferentially stated that negotiations would be resumed, he ended the letter with the words "as long as you take this position (that Mutual Gold had performed the contract) there can be no negotiations". The reason for sending this strong letter becomes clear when we remember that the board of directors did not specifically approve the agreement of September 2, 1938, until September 19th. Stimulated by the letter of September 9th, the board at its meeting of September 19, 1938 [Plaintiff's Exhibit 22, Tr. 300-305], read said "last notice of cancellation" and thereupon reconsidered its action of September 7th that the contract of September 2, 1938, be submitted to the stockholders and authorized its execution "if the previous ratification (by the stockholders on August 6th) is not legally sufficient". In a second motion they ratified the contract of September

2, 1938, in view of the authority and power given to the board by the stockholders' meeting of August 6, 1938. Another motion called off the stockholders' meeting of September 24, 1938, and the stockholders were so notified under date of September 20, 1938 [Tr. 299-300].

Garbutt felt very sure of himself during this course of events. The initial money for the power line was furnished perhaps a month before September 2, 1938 [Tr. 551, 552]. Garbutt was so anxious to obtain the contract and so certain he would obtain it that he did not want to risk not getting the power line started that year [Tr. 308, 563]. The $500.00 was advanced for that purpose before the contract with Mutual Gold and with the sword of forfeiture hanging over the company's head [Tr. 309, 763, 764, 766].

Another phase of Garbutt's activity was the loan of expense money for Director Grill's use, who was also an officer, stockholder and attorney for the company. He received $100.00 at one time and $150.00 at another for expenses [Tr. 402, 457, 458]. Garbutt proceeded to take control of the mine, to hire superintendents and to proceed further with his plans. On September 2, 1938, the very day of the second forfeiture letter, Garbutt was at the mine, paying his own expenses [Tr. 399]. Haley, Collins and Sturgeon were employed immediately after Garbutt took charge on September 2, 1938 [Tr. 359, 360, 388, 389, 758, 759], and frequent orders dispatched to them during the month of September, 1938 [Tr. 390-392, 298, 299].

Garbutt was careful not to deal with the stockholders of Mutual Gold. Obviously directors would be fewer and more easily handled. The reporter's transcript below, page 439, line 25, to page 440, line 7 (designated by plain-

tiff in this appeal at transcript page 801, but inadvertently omitted by the printer), is as follows:

> "Q. By Mr. Abel: Mr. Garbutt, did you take any steps to get the approval of the small stockholders to this transaction that is under attack? A. I never dealt with them at all. I dealt with the Mutual board of directors.
>
> Q. Yes. You never took any steps to find out whether small stockholders were satisfied with your deal or not? A. I don't know. I only know what they wrote me from time to time—strangers to me."

As a matter of fact, the minority were kept pretty well in the dark with respect to what was happening [Tr. 669, 670]. The quiet title suit brought by Garbutt did not come to the attention of W. H. Abel, Vance's attorney, and also one of the plaintiffs' and appellants' counsel, until after the case at bar was commenced [Tr. 670]. Plaintiff M. I. Higgens did not learn of it until Thanksgiving, 1939, after it had gone to default [Tr. 725, 736]. Bateham, the very active chairman of the stockholders' protective committee, himself a stockholder, knew nothing of it until after it had gone to default [Tr. 739, 741, 742, 744].

Garbutt took no chances in connection with driving through his cancellation threat. He even went so far as to state that if the full balance on the purchase price of the mine were paid he would not take it [Tr. 386-387]. Truly a strange way to protect the interests of his principal!

The effect of Garbutt's pressure and the key to the various actions of the board appears in President Stiegler's letter of September 12, 1938, to the stockholders, prepared after consultation with the company attorney [Tr. 292-294, 423, 424]. While the negotiations were in prog-

ress, says the president, the notice of cancellation was received from Garbutt. The board members thereupon conferred with Garbutt and obtained the contract, which was ratified, four directors voting in its favor. The gist of the letter is as follows:

> "It was the feeling of the writer, as well as of the other members of the board voting in favor of the contract, that if it was not accepted the company would become involved in long and expensive litigation with the owners of the property over the attempted cancellation of the contract and even though the company were ultimately successful in such litigation, little might remain for the stockholders after the termination thereof." [Tr. 294.]

Then follows an apology for not obtaining a better contract but, said the president, the board felt that the company had no alternative. We have seen, however, that the Vance contract was available and was indeed the only one mentioned in the notice of the stockholders' meeting of August 6, 1938.

Stiegler's attitude was the same after the meeting of September 19, 1938, as it was in the letter of September 12, 1938. In his covering letter enclosing the Garbutt progress report of September 23, 1938, Stiegler writes to the stockholders that the interests of the stockholders in the long run would have a greater value than if any other offer had been accepted "which would have occasioned unending litigation" [Tr. 313-314].

Garbutt, in his progress report of November 22, 1938 [Tr. 333-345], continues to hint broadly about default, referring specifically to tailings [Tr. 334] and stating he could not guarantee what might happen, but that the own-

ers of the mine were disposed to be lenient. He no doubt felt entirely secure as the letter contains no raking over of embers or the usual abuse of Vance. Most of it is taken up with a recital of what developments he has undertaken and either planned or completed.

On September 23, 1938, Garbutt wrote a long letter called a progress report to the board [Tr. 306-312]. This letter refers to a wire from the board of September 19th that his contract had been fully authorized and recites what he has done toward starting up operations and developing the mine, including guarantee of a survey and preliminary work on a power line before September 19th, and thereafter payment of $11,000.00 on the power line, employment of Collins and Haley, and other activities. There is an allusion to his termination of the purchase contract and his concern over the delay in entering into the contract of September 2, 1938, the agreements of the factions of Mutual Gold and the delay in arriving at its final ratification. The plain implication is that the pressure exerted by the forfeiture letters has been successful. Now the contract has been made and "fully authorized" and development work already begun [Tr. 309].

The witness Collins and the District Court both characterized the acts of Garbutt as "putting on the squeeze" [Tr. 414]. The Court's decision, however, did not carry this thought to its proper conclusion.

Garbutt got the approval of the owners to his cancellation. At first they objected to his taking the contract and terminated his authority [Tr. 314-319, 756, 757]. He explains that the forfeiture was withdrawn on October 15, 1938, by a notice from the owners [Tr. 765] because they had become assured that a contract had been made

which would cure the defaults and protect the property. In other words, they acquiesced in the successful culmination of the "squeeze" [Tr. 537].

Some attention is warranted to the nature of the alleged defaults. Garbutt's principal grounds of forfeiture were that Mutual Gold had allowed the 125-foot level to cave, and had wasted and lost the tailings, thereby incurring a damage claim [Tr. 532, 533]. These defaults could not have been very serious. When the purchase contract was reinstated there had been no correction of the so-called breaches. He took the contract as the mine stood and later opened up most of the caving himself, getting in the process some ore [Tr. 533, 552, 553]. The cavein extended for 50 to 60 feet and would cost $500.00 to remove. The mine was generally subject to caving [Tr. 672, 673, 675]. He solved the question of tailings by not taking title to them or the land on which they rested and by ordering his men not to touch them [Tr. 394, 534-536].

(b) Mutual Gold was not required to take the Garbutt deal from necessity as the Vance offer was at the same time available.

There can be no condonation as it were of Garbutt's illegal and improper compulsion. Mutual Gold was not required to take the Garbutt offer from necessity. It had a very real alternative to entering the contract with Garbutt, namely, to deal with Vance. This Garbutt himself admits [Tr. 755]. This fact appears time and again throughout the transcript. While the Vance offer was withdrawn, it was renewed on August 13, 1938 [Tr. 382]. When Garbutt's negotiations were commenced, Vance's offer was on the table and had in effect been accepted by

the board of directors. Vance agreed to make the purchase contract payment, to advance money and to proceed with the management. He had been manager of the mine and was familiar with its needs.

There were thus two persons ready, able and willing to carry on the corporation. At the board meeting of August 6, 1938, Director Ferbert, who always stood with Garbutt, urged the directors to deal with him, saying that Garbutt would take Vance's vehicle and pledge $86,000.00 of his own money "if the deal were turned over to him, and he would guarantee there would be no forfeiture of the contract or any trouble in that respect if he had the deal".

The record is replete with a comparison of Vance and Garbutt and their respective regimes. Appellants have no fear of such comparison of the abilities of Vance and Garbutt. But that is not the point of this case. No matter how able or how well financed a promoter might be, that does not make legal an *ultra vires* transaction, business compulsion or other illegal conduct. *The end does not justify the means, either in morals or in law.*

Nor do appellants fear a comparison of the reasonable and businesslike Vance offer with the oppressive and illegal Garbutt deal.

From the foregoing it is clear that the so-called forfeiture was merely a club to force Mutual Gold into line and to assure Garbutt's hold upon a majority of the board. He flourished it repeatedly and, as it turned out, successfully, while he went serenely on his way in control and possession of the mine, once having secured it. We submit that this was business compulsion at its worst. None of the contracts or conveyances escape this defect. For having obtained the September 2, 1938, contract and con-

veyances thereunder, Garbutt was in the saddle, and as a creditor, operator in possession, and with the majority of the board of Mutual Gold doing his bidding, he went on to the contracts of November 1 and December 17, 1938. The whole course of dealing was of one cloth. All the contracts and conveyances were therefore at least voidable. In support of this contention we cite the following authorities:

The common law doctrine of duress and coercion has been considerably liberalized in modern times so that now it includes "business compulsion"; that is, the coercion exerted requires the other party to execute an agreement on threat of pain of the latter's suffering serious business loss if he does not do so.

See:

17 *Corpus Juris Secundum* 536.

The doctrine was definitely upheld by the Supreme Court of Washington in the following case:

Duke v. Force (Wash., 1922), 208 Pac. 67, 74:

> "It is true that the old and established idea as to the character of duress and coercion necessary in order to constitute a payment involuntary has been greatly modified and relaxed by modern authorities. The tendency of the courts has been, and still is—and with that tendency this court has heretofore shown itself in accord (Olympia Brewing Co. v. State, 102 Wash. 494, 173 Pac. 430; Sunset Copper Co. v. Black, 115 Wash. 132, 196 Pac. 640)—that payments made under what, for lack of a better term, we may call *business compulsion* are to be held to be involuntary payments; that, where a person is called upon either to suffer a serious business loss or to make a

payment, he may recover that payment, when it has been illegally collected, as having been made involuntarily. It is unnecessary to determine absolutely whether the payments here were voluntary or involuntary to arrive at the proper determination of these suits, and we can assume that they were involuntarily made."

In *Ramp Bldgs. Corp. v. N. W. Bldg. Co.* (Wash., 1931), 4 Pac. (2d) 507, the cross-complaint filed by the defendant alleged that he had obtained a patent on certain construction devices; that it was necessary for him to borrow money by mortgagee in order to construct a plant; that the mortgagee was to advance money from time to time and not in a lump sum at the beginning; that plaintiff contended that defendant's patents were an infringement of his and told defendant that if he did not enter into a license agreement with plaintiff, defendant and the mortgagee would be subjected to infringement suits. Plaintiff in fact had notified the mortgagee of his claim of infringement and that he would bring a suit against the mortgagee if the latter made any further advances under the loan to defendant. Plaintiff further told defendant that he would cause the mortgagee to refuse further advances unless defendant entered into the license agreement with plaintiff. If defendant could not get this money it would cause him serious loss, and eventually become bankrupt.

Plaintiff's demurrer to this cross-complaint was sustained. However, on appeal the Supreme Court of Washington reversed the same, holding that defendant had set up a good cause of action under the doctrine of "business compulsion" (citing several cases from the State of Washington).

This case was cited with approval by the Supreme Court of Washington later on in *Marrazzo v. Orino* (Wash., 1938), 78 Pac. (2d) 181, where, however, the Court held that the facts did not bring the case within the "business compulsion" rule.

In *Oswald v. City of El Centro* (1930), 211 Cal. 45, 292 Pac. 1073, plaintiff was a contractor in the construction and improvement of city streets. He had entered into a contract with the city which required that the work should be completed by a certain date. However, it was impossible for plaintiff to complete it within the period, and he asked for a two weeks' extension. The evidence showed that this extension was reasonable because the period in which the improvements were to be completed was merely the result of an estimate made by the street superintendent as to the time it would ordinarily require for a completion of the work. The city, however, refused to grant any extension unless plaintiff would agree to lease to the city for a period of ten years at a nominal consideration of $1.00 per year certain equipment having a value of approximately $26,000.00. The city told him that unless he would execute such a lease he would not get the extension. Plaintiff then executed the lease and brought action to cancel it. The trial court refused cancellation and its judgment was reversed on appeal by the Supreme Court which held that, at page 52:

> "Clearly (the license) was the product of compulsion and the employment of coercive methods by which the exercise of freedom of will, which is always

essential to a valid contract, was unquestionably overcome by officers of the city acting under color of official authority."

Coercion and duress may result where the parties are not at arm's length and where one party is able to dictate to the other:

See:

17 *Corpus Juris Secundum* 536.

In *Davidson v. Bradford* (Iowa, 1927), 212 N. W. 476, 479, the Court referred to a quotation from 13 Corpus Juris 403, reading as follows:

> " 'Where the parties are not at arm's length, but one of them is in a position to dictate, the courts will treat agreements which are influenced by threats of injury to, or withholding of property as made under duress. . . . And the position of a public officer is generally such that persons acceding to illegal exactions on his part may be said to do so under duress.' "

Coercion or duress need not be the result of direct attack but can arise from indirect action.

In *Cochrane v. Nelson* (S. D., 1922), 189 N. W. 700, at 702, the Court said:

> "Coercion may be accomplished by a set of circumstances brought about by designing persons as effectually and as wrongfully as it may be accomplished by direct threats and menace."

Trusteeship.

Garbutt Dealt as a Trustee For Mutual Gold, as a Representative of Log Cabin and for Himself. The Transaction Is Presumed to Be Without Sufficient Consideration and the Attempt to Acquire the Beneficial Title Free of the Trust Is Void.

As has been argued *supra* in this brief, Garbutt was a trustee for Mutual Gold under the contract of November 1, 1938. As promoter of Log Cabin he was likewise its trustee, and as such his acts are subject to rigorous scrutiny. In negotiating the December 17th contract to which he himself was a party, he sat on both sides of the table, representing himself in his own interest, acting as trustee for Mutual Gold and likewise sitting as the representative of his creature corporation Log Cabin. Having dealt therefore with his beneficiary to his own advantage, the transaction is presumed to be without sufficient consideration and the attempt to acquire the beneficial title free of the trust is unavailing.

Buffum v. Peter Barceloux Co., 289 U. S. 227, 77 L. Ed. 1140;

Elliott v. Landis Mach. Co. (Mo. 1911), 139 S. W. 356.

The Supreme Court of Washington in *Ennis v. New World Life Insurance Co.* (1917), 97 Wash. 122, 165 Pac. 1091, 1095, said:

". . . It is settled law that the promoters of a corporation stand in a fiduciary relation to the cor-

poration, and are bound by the principles governing persons acting in a fiduciary capacity. It has been held that the gratuitous issue of corporate stock by promoters to themselves is a fraud on existing stockholders."

Also, in the same Washington case, 97 Wash., at page 135, 165 Pac., at page 1095, the following from *Thompson on Corporations* (3d ed.), Sec. 104, is quoted with approval:

> "From this fiduciary relation it follows that the promoters must deal with the persons who come into the organization as members or stockholders in the utmost good faith . . . If the promoters obtain secret profits out of any transactions, and either they themselves become members of the board of directors, or persons under their control are elected as such directors, and the board thus composed adopts and ratifies the voidable transaction—this, it has been held, will create no impediment to proceedings by stockholders for redress."

See also:

Pepper v. Litton, 308 U. S. 295, 84 L. Ed. 281.

It follows that Log Cabin received and now holds nothing more than paper to the mine claims of Mutual Gold. Ferbert, Stiegler, Grill and Garbutt were all trustees and in turn Log Cabin likewise holds Mutual Gold's property for it as trustee.

Common Directors.

The Transactions Are Void Because There Were Common Directors on the Boards of Directors of Mutual Gold and Log Cabin.

Subsequent to the organization of Log Cabin on October 18, 1938, there were common directors for that company and for Mutual Gold. It is to be remembered that the majority of the five men on the board of directors of Log Cabin were at all times selected by Garbutt [Finding XX, Tr. 193]. On November 2, 1938, Collins, Grill and Ferbert were elected to fill the places of certain resigned members of Log Cabin. These men were on the board of Mutual Gold [Plaintiff's Exhibit 60, Tr. 351] which consisted of seven members. Grill was the attorney for Mutual Gold and assistant secretary of Log Cabin. This lineup continued into the meeting of January 4, 1939 of Log Cabin and thus covered the period of the execution of the November 1, and December 17, 1938 contracts. See the following references:

Mutual Gold directors' meetings of November 7, 28, December 9 and 17, 1938 [Tr. 322-324, 325, 326-327, 327-329;

Log Cabin directors' meeting of January 4, 1939 [Tr. 329-332].

All presumptions are against the good faith of transactions between corporations having common directors, as did Mutual Gold and Log Cabin. Such transactions are regarded as jealously by the law as are personal dealings

between a director and his corporation. The rule also applies to dealings between corporations, one of which was promoted and organized by the officers of the other. Bearing in mind that Ferbert, Collins and Grill, directors of Mutual Gold, were likewise directors almost from the beginning of Log Cabin, the following from *Geddes v. Anaconda Copper Mining Co.*, 254 U. S. 590, 65 L. Ed. 425, at page 432, is squarely in point:

> "The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation; and where the fairness of such transactions is challenged, the burden is upon those who would maintain them to show their entire fairness; and where a sale is involved, the full adequacy of the consideration. *Especially is this true where a common director is dominating* in influence or in character."

Also:

McCandless v. Furland, 296 U. S. 140, 80 L. Ed. 121;

Alexander v. Hillman, 296 U. S. 222, 80 L. Ed. 192;

Garrett v. Reid-Cashion Land & Cattle Co., 270 Pac. 1044.

Before concluding the argument, we direct the Court's attention to the first paragraph of the opinion of the District Court, stating that the case at bar is in one sense

a re-enactment of *Vance v. Mutual Gold Corporation* (Wash. 1940), 108 Pac. (2d) 799. In order that there may be no misunderstanding as to the effect of said Washington case this Court will note that it dealt with claims upon the indebtedness of Mutual Gold and is in no sense *res adjudicata* or binding here. The judgment dismissing the action *without prejudice* [Tr. 657] was affirmed by the Supreme Court. (108 Pac. (2d) 801.)

Conclusion.

The transactions complained of were void for *ultra vires* involved in not securing unanimous stockholder approval, or cash, as required by the common law in effect when Mutual Gold was organized. The law adopted after the organization of Mutual Gold by its terms did not authorize the transactions because such would be an unconstitutional interference with vested rights, and in any event did not apply because Mutual Gold did not amend its articles to render it applicable, as the act itself required. Mutual Gold could not subscribe for stock or transfer substantially all its assets without adequate consideration or render itself a shell and abrogate its corporate functions. Its acts were illegal because of lack of proper notice to the stockholders. Furthermore the transactions were induced by business compulsion and are therefore void or voidable. They are also illegal because of trustee and common director relationships.

Appellants submit that paragraph one of the judgment below be reversed and the cause remanded with direction

for further proceedings consistent with said reversal and the prayer of the complaint [Tr. 20-21] including cancellation of the agreements, deeds, bills of sale and assignments of the purchase contract whereby Mutual Gold purported to divest itself of its assets, and including an accounting with respect to all ores and the proceeds mined or extracted by Garbutt or Log Cabin. Much of the trial court's time was taken up by evidence more properly presentable later at an accounting. Upon reversal as prayed an accounting and restitution may be had in the light of applicable principles.

Respectfully submitted,

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